

March 13<sup>th</sup>. 2019

Ann E. Misback, Secretary  
Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue N.W.  
Washington, D.C. 20551

Robert E. Feldman, Executive Secretary  
Attention: Comments/RIN 3064-AE80  
Federal Deposit Insurance Corporation  
550 17th Street N.W.  
Washington, D.C. 20429

Legislative and Regulatory Activities Division  
Office of the Comptroller of the Currency  
400 7<sup>th</sup> Street S.W., Suite 3E-218  
Washington, D.C. 20219

**Re: Comment to Notice of Proposed Rulemaking –*Standardized Approach for Calculating the Exposure Amount of Derivative Contracts* [Docket No. R-1629 and RIN 7100-AF22; RIN 3064-AE80; Docket ID OCC-2018-0030]**

Dear Sir/Madam,

Thank you for the opportunity to comment on the proposal to amend the SA-CCR's standardized approach for calculating the exposure amount for derivative contracts (the "Proposal")<sup>1</sup> issued jointly by the Board of Governors of the Federal Reserve System ("FRB"), the Federal Deposit Insurance Corporation ("FDIC"), and the Office of the Comptroller of the Currency ("OCC") (together, the FRB, FDIC and OCC are the "Agencies").

The Agencies' Proposal would likely have a significant impact on the liquidity of the derivatives market. As a commercial end-user, Cummins Inc. is particularly concerned about the potential cost implications to commercial end-users who benefit from using derivatives for hedging purposes. If the Proposal is adopted as it currently stands, we believe that the new approach for calculating exposure amounts for derivatives contracts could severely impact the ability of commercial end-users to cost-effectively access price-hedging products. We recognize that Cummins Inc. is not directly required to comply with the Proposal's requirements; however, it is important to emphasize that the second-order effects of the Proposal would create a hardship for Cummins Inc.

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<sup>1</sup> FRB, OCC and FDIC, Notice of Proposed Rulemaking, *Standardized Approach for Calculating the Exposure Amount of Derivative Contracts*, 83 Fed. Reg. 64660 (Dec. 11, 2018).



In this letter, we discuss how the Proposal is likely to affect our business' ability to manage operational risks and the impact that the Proposal will have on commercial-end users in general through the Proposal's effect on the broader derivatives market.

### **The Proposal's Likely Impact on Cummins Inc. Business**

**Cummins Inc., a global power leader, is a corporation of complementary business units that design, manufacture, distribute and service a broad portfolio of power solutions. The company's products range from diesel and natural gas engines to hybrid and electric platforms, as well as related technologies, including battery systems, fuel systems, controls, air handling, filtration, emission solutions and electrical power generation systems. Headquartered in Columbus, Indiana (U.S.A.), since its founding in 1919, Cummins employs approximately 62,600 people committed to powering a more prosperous world through three global corporate responsibility priorities critical to healthy communities: education, environment and equality of opportunity. Cummins serves customers in approximately 190 countries and territories through a network of approximately 600 company-owned and independent distributor locations and over 7,600 dealer locations and earned about \$2.1 billion on sales of \$23.8 billion in 2018.**

To serve our customers and to help manage its complex business, Cummins Inc. depends upon interest rate, FX and commodity derivatives markets to help manage its business in meeting the needs of its customers. These markets not only play a critical role in assisting Cummins Inc. with conducting its day-to-day business, but also serve as effective mechanisms in which we manage market and commercial risks.

Cummins Inc. executes derivative transactions with large bank counterparties to cost-effectively hedge our business operational risks. Cummins Inc. therefore submits these comments on the Proposal to protect our ability to risk-manage our operations. Of primary concern to Cummins Inc. is the Proposal's revision to risk weighting of derivatives transactions under SA-CCR which would result in dramatic increases to the capital requirements imposed on our bank counterparties and would ultimately fall on commercial end-users by way of higher derivatives transaction costs. In addition to reducing access to risk hedging, the Proposal threatens to increase overall market risks and costs, and market instability.

#### **Cummins Inc. Concerns are as Follows:**

Cummins Inc. has three primary concerns regarding the Proposal:

1. The Proposal, if put into effect, would undermine the protections that Congress has enacted for end-users, specifically, the exceptions and exemptions granted to Cummins Inc. and other commercial end-users under the Commodity Futures Trading Commission's ("CFTC") and Agencies' regulations;



2. The Proposal would impose burdens on bank counterparties resulting in a decrease in the number of bank counterparties willing to engage in derivatives transactions, thereby creating a less competitive and less efficient marketplace; and
3. The Proposal disadvantages Cummins Inc. in relation to foreign competitors, who would not bear the cost of the Proposal.

### **1. The Proposal Undermines Statutory End-User Exceptions and Exemptions**

Currently, Cummins Inc. and other commercial end-users are exempted from having their hedging transactions be subject to the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”)<sup>2</sup> clearing and margin requirements under the CFTC’s end-user exception and the Agencies’ and CFTC’s respective end-user exemptions from uncleared swap margin requirements. These exceptions and exemptions are imperative to Cummins Inc. and other U.S. businesses ability to cost effectively mitigate their commercial risk, and were enacted by Congress to promote the use of derivative transactions by such businesses.

Having reviewed the Proposal, we believe the proposed calculations under SA-CCR would negate the benefits of the exceptions and exemptions from derivatives regulations, which Congress explicitly provided to Cummins Inc. and other end-users in Dodd-Frank by increasing the metrics used to calculate bank counterparties’ risk exposures on derivatives transactions with us.

Cummins Inc. today has more than \$3 billion in derivatives outstanding across its foreign currency, commodity and interest rate risk programs. As an example of how the Proposal will impact our financial hedging programs, Cummins Inc. uses interest rate SWAP’s to convert its fixed rate debt to floating rate debt. Our current Interest Rate Swap position of \$500M today qualifies for the End-User Exception. To combat volatility and ensure stable pricing and cash flow, we enter swaps to help mitigate our operational risks. An example best illustrates the potential impact.

If we were to enter into a 25-year \$500 million Interest Rate SWAP today, current regulations would impose a 1.5% potential future exposure (PFE) risk weighting to the notional value of the contract, equal to \$7,500,000. Under the Proposal, Interest Rate SWAP contracts would now be subject to a 10% potential future exposure risk weighting on the notional value of this contract, equal to \$50,000,000, which represents a 566% increase in the potential future exposure amount that our counterparty must retain capital against. If we assume a cost of capital hurdle return rate at the bank of ~10%, this would imply a risk of pass through charges that could exceed \$5 million. We currently estimate across our trading exposures that because of this Proposal, our risk management program may incur incremental costs of more than \$20 million.

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<sup>2</sup> 12 USC § 5301 *et seq.* (2010).



As a result, the exemptions and exceptions that Cummins Inc. currently relies and that Congress recognized as important for businesses mitigating commercial risks, would ultimately disappear entirely because of the Proposal, as bank counterparties would be required to hold an excessive amount of capital against Cummins Inc. interest rate, FX and commodity derivatives transactions. We believe these costs will ultimately be passed onto Cummins Inc. and other commercial end-users, resulting in higher transaction costs or unhedged business risks.

## **2. The Proposal's Effect on the Derivatives Market Generally and More Broadly**

In addition to forcing extra costs onto end-users, the Proposal would result in less-liquid derivatives markets. Deep, competitively priced markets are essential to effective and efficient commercial hedging. Cummins Inc. is concerned this Proposal would decrease overall market depth which threatens to have a tremendous effect on a sector already being shrunk by increased legislative and regulatory scrutiny. By increasing the costs imposed on bank counterparties, the Proposal threatens to decrease the number of bank counterparties that are willing, or even are able, to engage in derivatives transactions with businesses such as Cummins Inc.

## **3. The Proposal Threatens Our Ability to Engage in Business Abroad**

Considering foreign efforts to implement SA-CCR<sup>3</sup>, the adoption of the Proposal is likely taking place too soon. Since Cummins Inc. and other commercial end-users would incur costs because of SA-CCR changes in the United States that would not be imposed on similar derivatives transactions entered into by foreign end-users, adoption of the Proposal could inadvertently place Cummins Inc. at a disadvantage to its foreign competitors. This economic advantage would be the result of nothing more than foreign banking counterparties not being subject to the SA-CCR calculations. We ask, therefore, that Agencies reconsider the timing of its proposed compliance date for the Proposal, considering the necessity of creating a level global playing field.

## **Conclusion**

Because the Proposal is likely to undermine the exceptions granted by statute to end users, create a less efficient and less competitive derivatives marketplace, and put U.S. businesses at a disadvantage as compared to their foreign counterparts, we respectfully ask that the Agencies adopt an exemption from SA-CCR for derivatives transactions entered into by Bank Counterparties and commercial end-users. As drafted, the Proposal would directly increase Cummins Inc. cost of managing commercial risk by creating costlier, and possibly cost-

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<sup>3</sup> As of the latest implementation progress report published by the Basel Committee on Banking Supervision, Canada, Hong Kong, Mexico, Russia, Switzerland, and the EU have not yet implemented SA-CCR. BCBS, *Fifteenth progress report on adoption of the Basel regulatory framework* (Oct. 26, 2018), available at <https://www.bis.org/bcbs/publ/d452.htm>.



prohibitive, derivatives transactions that would have otherwise qualify for the end-user exception and exemption from margin requirements on uncleared derivatives.

Sincerely,

A handwritten signature in black ink, appearing to read 'Donald G. Jackson'.

**Donald G. Jackson**  
Vice President & Treasurer

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